PINNACLE PETROLEUMS LTD.

ANNUAL REPORT 1972

Five Year Summary

	1972	1971	1970	1969	1968
Revenues	$ 292,869	$ 289,385	$ 293,899	$ 269,436	$ 245,750
Expenses	247,550	434,859	607,291	381,265	371,291
Cash Flow (Loss)	45,319	(145,474)	(313,392)	(111,829)	(125,541)
Net Loss (Before Extraordinary Items)	(87,097)	(302,438)	(2,505,644)	(280,464)	(316,566)
Extraordinary Items	762,089	(376,817)	(1,600,000)	—	—
Net Earnings (Loss)	674,992	(679,255)	(4,105,644)	(280,464)	(316,566)
Shares Outstanding	5,380,895	5,380,895	5,380,895	3,818,500	3,554,500

Letter to the Shareholders

I am particularly pleased to report to you on the first year of operations since the corporate reorganization of your Company. As you know, Management's first responsibility under the reorganization was to bring the revenues and costs of the company's operation into balance. A review of the five year summary in this report will show that we have not only been able to accomplish this, but more encouragingly, to produce for the first time in five years a positive cash flow from the company's revenue. The financial condition of the company is discussed in detail in the body of this report and I would ask that you read it carefully, particularly in regard to the comments made on the net earnings for the year. With a change in management it is essential, I think, to set out general corporate policy so that all the shareholders recognize the directions and goals of the Company.

Our exploration program will be concentrated in the conventional oil and gas producing areas of Western Canada. We will continue to operate internationally, perhaps increasing our activity in this area as opportunities present themselves. It is our policy to both reduce our costs and broaden our participation by seeking partners in most of our exploration ventures.

Our position in minerals exploration, which now accounts for about 15% of the budget, will be maintained but not increased. Additions are being made to our technical staff which should result in the expansion of our exploration activity and the accommodation of an increased budget.

Results of our exploration, producing and mining activity for the year are presented on the following pages.

The next few years will be a critical and important time for the oil industry. The demand for energy, particularly natural gas, continues to increase. In fact, many recent studies are predicting shortages of fuel in North America of crisis proportions. The industry is capable of mounting the exploration program necessary to meet this challenge only if it can receive realistic prices for its products and fair and equitable treatment in the area of taxation.

I would like to acknowledge specifically the dedication of the Company's small staff. Without this help the encouraging position of the Company today would not have been possible.

Very truly yours,

J. R. Schmid

August 4, 1972

Oil and Gas Exploration - Canada

GAS EXPLORATION

The Company is beginning an aggressive lease acquisition program in several geologically selected gas prone areas and we expect to have amassed a sizeable acreage position by the end of the year. When leasing is complete, we will then be in a position to announce details of the acquisition and the multi-well program necessary to properly explore the acreage.

MAJORVILLE

A Basal Quartz oil discovery has been drilled on acreage farmed-out by the Company in the Majorville area of southern Alberta. The well is currently being production tested and its producing capacity will be observed for a reasonable length of time before development drilling begins. Pinnacle's interest is an overriding royalty and a cash payment convertible to a 12½% working interest on a large block of 9,400 acres.

CHEDDERVILLE

Negotiations are continuing among our partners and outside land owners to find an equitable solution to the complex land problems involved in this important "deep reef" gas prospect. We hope that at least one test will be drilled on the block within the next 12 months.

CHIGWELL

A 6,900 foot Devonian reef test was drilled on a 1,400 acre block in the Chigwell area of central Alberta in which the Company holds a 3% overriding royalty. The well was dry and abandoned after encountering no significant shows of oil or gas. The leases, however, are being maintained and Pinnacle's overriding royalty remains intact.

LEAHURST

The Company has leased 3,700 acres within the boundary of the Leahurst gas field in central Alberta. It is in a township in which the Company already holds varying interests in 6,400 acres. Pinnacle has a contract for the sale of gas from this acreage and drilling will take place when the few remaining leases necessary to the play are acquired.

ARCTIC ISLANDS

Panarctic Oils Ltd. is maintaining 3,491,169 acres in permit form on Prince of Wales Island in the Arctic on which the Company holds a 3% overriding royalty. Sun Oil Company, on farmout from Panarctic, drilled a 6,020 foot Paleozic test on Russell Island some 28 miles from these permits. The well was abandoned in January, 1972 and all information is being kept confidential. We do not expect any drilling activity on our permits in the coming year.

Oil and Gas Exploration - United Kingdom

Pinnacle, through its wholly owned subsidiary Grizzly Exploration (U.K.) Ltd., holds 2,038,727 acres of landward licences concentrated in the Midlands and Bristol-Bath areas of central and southern England. Considerable exploration activity by other companies directly affecting our licences is continuing to take place. Most importantly is a proposed 3,000 foot test to be spudded before the end of August at Marston in Wiltshire only four miles from our Bristol production licence No. 064. The well is apparently testing a Carboniferous structure in geologic conditions similar to those that exist on our permits. The well is very critical to Pinnacle's acreage position and our exploration program will be governed to a great extent by the results of this test.

North of here near our Midlands block, seismic crews are working on permits adjoining us both to the northwest and the southeast. A previously reported gas show in a well in Oxfordshire some 30 miles to the southeast of our acreage, was followed up by a step-out well which is understood to have encountered encouraging reservoir conditions but no commercial production.

Environmental and ecological objections to onshore exploration activity in Britain are becoming quite strong and present a difficult problem for companies holding licences. Without doubt, the costs of exploration will increase significantly because of this. In addition, the Ministry has suspended issuance of any further landward production licences pending the formulation of policy in regard to environmental problems. This suspension directly affects the Company as it has an application pending for a permit which is important to our further exploration program on the Midlands block. While the level of activity is higher than it has been in the past, the increasing difficulty of keeping exploration costs within reasonable limits and the initial disappointing results of exploration so far could have, unfortunately, a detrimental effect on exploration in this very attractive geologic area.

Minerals Exploration

CHIBOUGAMAU, QUEBEC

Pinnacle is conducting an extensive mineral exploration program on properties in the Chibougamau area of Quebec. Originally, 29 claims were involved but two additional claims have been staked based on the results of our program so far. The prospect stretches some 3½ miles along the Grenville fault zone and abuts the Icon producing copper mine to the southeast.

A 60% interest in the claims will be earned by the Company through its exploration work and the program must be completed by February 1, 1973. Exploration has included photogeologic studies and a limited amount of diamond drilling but the major expenditures have been on a series of geochemical programs. New and advanced concepts are being used in the surveys and the preliminary reports indicate several very good geochemical anomalies which could represent areas of mineralization. The final reports fully integrating all information will not be available, however, until mid-September. The further exploration of the claims will be determined by these results.

COPPERKETTLE CREEK, BRITISH COLUMBIA

The Company holds a 10% interest in one mineral lease and ten mining claims on a copper and molybdenum prospect in the Greenwood mining district of British Columbia. Previous trenching on the properties yielded assay results of up to .83% copper and .156% molybdenum sulphate. The claims are in good standing until 1977 and we have budgeted no funds for additional exploration this year.

Production

The Company has varying interests in 43 oil wells and 9 oil and gas units in Canada and the United States. We operate 17% of our production with Alberta accounting for 42% and Saskatchewan 56% of the revenue. Net production last year was 112,340 barrels, an increase of 15% over 1971. As part of the critical evaluation of the Company, a detailed analysis of all our producing properties was undertaken during the course of the year and recommendations were made regarding many of the wells. Consequently, remedial work has been completed on wells which represent 90% of the Company's producing capacity and we should see the results in increased production in the coming year. Several leases which had been suspended have now been properly abandoned to the satisfaction of the appropriate Government Agencies and the surplus equipment sold. One well which had been suspended was put back on production and is operating profitably.

Pinnacle has a small interest in the Donalda Gas Unit in central Alberta which went on stream last year and is a participant in the newly formed Belly River 'B' Unit. This latter unit, which should start water injection later this year, could well result in a very significant increase in the Company's oil reserves and cash flow from the enhanced secondary recovery.

The province of Alberta announced on July 29, 1972 a tax on oil reserves in the ground. Operating companies in the Province would have an option of agreeing to an increased royalty of up to 25% on their current leases in lieu of this reserves tax. The present maximum royalty is 16⅔%. Future leases issued by the Province will carry this increased royalty and all new legislation will be in effect January 1, 1973. Since the amount of tax on reserves has not been announced, real comparisons between the alternatives can not, at this time, be made.

Coupled with the increased taxation will be an exploration incentive scheme which will allow discovery wells to produce royalty free for a period of five years. In addition, certain tax credits will be allowed on all exploratory wildcat wells whether they are successful or not. While the incentive scheme will be a stimulus to the Company's exploration programs, the effect of the increased taxation on the profitability of the Company's production can only be known after all details of the plans are in final form.

Financial

The success of the effort to bring maximum efficiencies to the Company's operation is well reflected in the 1972 Financial Statements. Revenues from oil and gas sales were $251,244, up 17% from last year, while General and Administrative expenses were cut by 41%. This, combined with other efficiencies, resulted in a cash flow of $45,319, an improvement of 131% over the previous year.

There is, this year, in addition to the ordinary operating revenues of the Company, an extraordinary gain of $762,089. The gain is the result of an agreement under which 1,541,700 pledged shares of the Company's stock became the property of Greyhound Leasing & Financial Corporation at an agreed value of $1,700,000 (U.S.) a sum in excess of that carried on the Company's books. This in turn produced net earnings of $674,992, the first in the Company's history. The item is fully discussed in Note 3 to the Financial Statements but the important thing is that Shareholders recognize the non-recurring nature of the income which produced these net earnings.

Another important item to the Company is a Note Receivable in the amount of $224,500 which is the balance after payments of $46,077. A new Financing Agreement has been signed which includes the addition of significant collateral greatly improving the Company's security.

Your Company has now been brought to a point of financial stability and every effort will be continued to maintain this healthy position.

Consolidated Statement of Earnings and Deficit

Year ended March 31, 1972
(with comparative figures for 1971)

	1972	1971
REVENUES:		
Crude oil and gas sales and royalties	$ 251,244	213,932
Interest and other income	41,625	75,453
	292,869	289,385
EXPENSES:		
Operating	94,813	101,118
General and administrative	152,387	258,405
Foreign exploration	—	25,547
Interest—long-term	—	45,747
—other	350	4,042
	247,550	434,859
CASH FLOW (LOSS) FROM OPERATIONS	45,319	(145,474)
DEDUCT:		
Depreciation	49,274	57,807
Depletion	83,142	66,528
Bad debts	—	32,629
	132,416	156,964
Net (loss) before extraordinary items	(87,097)	(302,438)
EXTRAORDINARY ITEMS:		
Realization (provision for deficiency) under an agreement (Note 3)	762,089	(503,135)
Gain on sale of production equipment	—	126,318
	762,089	(376,817)
Net earnings (loss)	674,992	(679,255)
DEFICIT, BEGINNING OF YEAR	(5,685,783)	(5,006,528)
DEFICIT, END OF YEAR	$5,010,791	5,685,783
EARNINGS (LOSS) PER SHARE:		
Loss before extraordinary items	$ (.02)	(.06)
Net earnings (loss)	$ .13	(.13)

See accompanying notes.

Consolidated Balance Sheet

March 31, 1972
(with comparative figures for 1971)

ASSETS

	1972	1971
CURRENT ASSETS:		
Cash	$ 19,991	—
Short-term deposits	555,000	610,000
Accounts receivable	42,522	60,724
Prepaid expenses	1,967	2,481
Total current assets	619,480	673,205
NOTES RECEIVABLE INCLUDING ACCRUED INTEREST (Notes 2 and 6)	224,500	247,295
DEFERRED ACCOUNTS RECEIVABLE	26,905	21,240
PROPERTY AND EQUIPMENT, AT COST LESS DEPLETION AND DEPRECIATION (Note 1):		
Petroleum and natural gas properties	1,409,729	1,320,460
Less accumulated depletion	643,577	560,435
	766,152	760,025
Production and other equipment	432,660	429,709
Less accumulated depreciation	307,851	276,302
	124,809	153,407
Mineral properties	64,079	52,511
Net property and equipment	955,040	965,943
OTHER ASSETS:		
Drilling and other deposits, at cost less amounts written off	42,756	42,756
Drilling rig held for sale—at cost less accumulated depreciation	22,800	32,572
Incorporation costs	5,401	5,401
Agreement by D. Bruce Bullock & Associates Ltd. to assume liability of loan due to Greyhound Leasing & Financial Corporation (Note 3)	1,341,046	3,105,135
Less allowance for loss	1,341,046	2,103,135
	—	1,002,000
	70,957	1,082,729
	$1,896,882	2,990,412

See accompanying notes.

LIABILITIES

	1972	1971
CURRENT LIABILITIES:		
Bank overdraft	$ —	3,778
Accounts payable and accrued liabilities	41,263	72,212
Demand loan and accrued interest thereon (Note 3) .	1,039,023	2,626,000
Total current liabilities	1,080,286	2,701,990
DEFERRED GAIN ON FOREIGN EXCHANGE	—	177,112
DEFERRED INCOME (Note 2)	52,588	22,294
SHAREHOLDERS' EQUITY:		
Share capital (Note 4):		
Authorized 7,000,000 shares without nominal or par value		
Issued 5,380,895 shares	5,774,799	5,774,799
Deficit	5,010,791	5,685,783
	764,008	89,016
	$1,896,882	2,990,412

On behalf of the Board:

"W. H. MOLLE", Director

"R. L. BORDEN", Director

Consolidated Statement of Source and Application of Funds

Year ended March 31, 1972
(with comparative figures for 1971)

	1972	1971
SOURCE OF FUNDS:		
Cash flow (loss) from operations	$ 45,319	(145,474)
Net proceeds from sale of properties and equipment	8,356	3,788,754
Repayments on note receivable	46,077	—
Partial settlement under an agreement net of deferred gain on exchange (Note 3)	1,726,000	—
Sundry	927	6,443
Total funds provided	1,826,679	3,649,723
USE OF FUNDS:		
Purchase of property and equipment	119,677	443,212
Reduction of bank loans	—	513,275
Demand bank loan transferred to current liabilities	—	2,626,000
Advances on behalf of D. Bruce Bullock & Associates Ltd. (Note 3)	139,023	302,023
Note receivable	—	225,000
Total funds applied	258,700	4,109,510
DECREASE (INCREASE) IN WORKING CAPITAL DEFICIENCY	$1,567,979	(459,787)

See accompanying notes.

Notes to Consolidated Financial Statements

March 31, 1972

1. Principles of Consolidation:

The consolidated financial statements include the accounts of Pinnacle Petroleums Ltd. and those of its wholly-owned subsidiary companies, Baldonnel Oil & Gas Ltd., Midalta Oil Company Limited and Grizzly Petroleum Limited and its wholly-owned subsidiary, Grizzly Petroleum (U.K.) Ltd.

The excess of the purchase price of the shares of the subsidiaries over their underlying net book values at dates of acquisition amounting to $2,567,698 has, on consolidation, been added to petroleum and natural gas properties and is being depleted on consolidation.

The companies follow the "full cost" method of accounting wherein all costs and expenses of exploring for and developing oil and natural gas reserves in Canada are capitalized and depleted over the production lives of the properties on a composite unit of production basis. In 1970 the company wrote down the carrying value of its petroleum and natural gas properties $1,960,000.

2. Note Receivable:

At March 31, 1972 the 8% note receivable was in default; however, under an agreement dated May 19, 1972, it has been renegotiated. (See Note 6.) Accordingly, interest earned to March 31, 1972 has been included in deferred income on the consolidated balance sheet rather than being shown as income earned in the consolidated statement of earnings and deficit pending final realization.

3. Other Assets:

Prior to becoming a wholly-owned subsidiary, Midalta Oil Company Limited had sold to D. Bruce Bullock & Associates Ltd., (all of the issued shares of which were owned by former officers of Pinnacle Petroleums Ltd.) shares of Pinnacle Petroleums Ltd., at a price of $2,600,000 U.S. Funds ($2,803,112 Canadian Funds as at that date) and agreed to assume obligations both present and contingent, including a demand loan of $2,600,000 payable to a bank which was secured by the pledge of 1,541,700 shares of Pinnacle Petroleums Ltd. As of June 9, 1971 this loan including all of the bank's rights, title interest and security in such loan was assumed by Greyhound Leasing & Financial Corporation. In 1970, Midalta Oil Company Limited advanced a further $302,023 on behalf of D. Bruce Bullock & Associates Ltd., in connection with interest and other obligations under the agreement. The sale of shares and advances to D. Bruce Bullock & Associates Ltd., were recorded in the accounts at March 31, 1971 in the amount of $3,105,135, less an accumulated allowance of $2,103,135 being the estimated deficiency in the market value of the 1,541,700 shares pledged.

In December 1971, under an agreement, the pledged 1,541,700 shares of Pinnacle Petroleums Ltd., held by Greyhound Leasing & Financial Corporation became their property at an agreed valuation of $1,700,000 U.S. Funds ($1,903,113 Canadian Funds). Accordingly the original indebtedness due from D. Bruce Bullock & Associates Ltd. has been reduced by a similar amount which has resulted in an extraordinary gain of $762,089.

The remaining indebtedness of $900,000 U.S. Funds due to Greyhound Leasing & Financial Corporation by Midalta Oil Company Limited was due on December 31, 1971. Interest is payable at the rate obtained by adding to the minimum New York prime rate for United States dollars an additional rate of 2½% per annum. Accrued interest from June 9, 1971 to March 31, 1972 of $139,023 has been provided and charged to D. Bruce Bullock & Associates Ltd., under the terms of that sale agreement, but an allowance for the accrued interest due has been charged against the extraordinary gain.

4. Stock Option:

The company has granted to an officer an option to purchase up to 25,000 shares in the capital stock of the company at \$.67 per share. The shares are exercisable 1/5 per annum on a cumulative basis, commencing April 7, 1972 and expiring on April 6, 1976 or in any event one year after termination of employment, whichever is earlier.

During the year options for 17,000 shares were cancelled as a result of the termination of employment.

5. Income Taxes:

For income tax purposes the companies are entitled to claim drilling, exploration and lease acquisition costs and capital cost allowances (depreciation for tax purposes) in amounts which may exceed the related depletion and depreciation provisions reflected in the accounts. For 1971 the companies do not intend to claim excess capital cost allowances, but will claim the other specified deductions in amounts sufficient to eliminate taxable incomes, and expenditures remaining to be carried forward and applied against future taxable income are as follows:

Drilling, exploration and lease acquisition costs	\$1,911,234
Undepreciated capital cost .	\$ 171,617

6. Subsequent Event:

Subsequent to March 31, 1972 certain legal action has been taken, under the terms of an agreement, to obtain additional specific and collateral security for the repayment of the note receivable. In addition, the company has amended the terms of the agreement whereby the interest rate is reduced effective May 19, 1972 from 8% to 7% per annum and will be payable in instalments on or before December 29, 1972.

7. Remuneration:

The aggregate remuneration paid to directors and senior officers during the year was \$39,300.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Pinnacle Petroleums Ltd. and subsidiary companies as of March 31, 1972 and the consolidated statements of earnings and deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company and its subsidiary companies at March 31, 1972 and the results of their operations and the source and application of their funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
April 7, 1972
(except May 19, 1972
as to Note 6)

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

HEAD OFFICE:

340 Crown Trust Building
407 - 8th Avenue S.W.
Calgary, Alberta
T2P 1E5

DIRECTORS:

R. L. Borden, Calgary, Alberta
D. B. Bullock, Calgary, Alberta
W. C. Bumpers, Phoenix, Arizona
R. S. Grim, Phoenix, Arizona
W. H. Molle, Toronto, Ontario
Alexander Muirhead, Calgary, Alberta
John Thompson, Toronto, Ontario

OFFICERS:

W. H. Molle, President
J. R. Schmid, Executive Vice-President
and General Manager
Peter Floyd, Secretary

AUDITORS:

Peat, Marwick, Mitchell & Co.,
Calgary, Alberta

SOLICITORS:

McLaws & Co.
Calgary, Alberta

BANKERS:

The Bank of Montreal, Main Branch
Calgary, Alberta

REGISTRAR:

Montreal Trust Company,
at its offices:

Calgary, Alberta
Vancouver, B.C.
Toronto, Ontario
Montreal, Quebec

LISTING:

Toronto Stock Exchange

ANNUAL MEETING:

The Annual Meeting will be held at 10:00 a.m., Monday, August 28, 1972 at the Lake Louise Room, Calgary Inn, 4th Avenue and 3rd Street S.W., Calgary, Alberta.

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